

# **CALIFORNIA LOTTERY**

Audit Report

## **ACCOUNTS RECEIVABLE**

*July 1, 2009, through June 30, 2011*



**JOHN CHIANG**  
California State Controller

October 2012



**JOHN CHIANG**  
**California State Controller**

October 3, 2012

Phil Tagami, Chairperson  
California Lottery Commission  
700 North Tenth Street  
Sacramento, CA 95811

Dear Mr. Tagami:

The State Controller's Office audited the California Lottery's (Lottery) accounts receivable for the period of July 1, 2009, through June 30, 2011.

Our audit disclosed that the Lottery did not identify uncollectible amounts for discharge and maintain adequate documentation to support collection efforts, and accounts receivable were not reviewed and discharged quarterly.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/sk

cc: Nathaniel Kirtman III, Commissioner  
California Lottery Commission  
Gregory Ahern, Commissioner  
California Lottery Commission  
Connie M. Perez, Commissioner  
California Lottery Commission  
John Smolin, Vice-Chairperson  
California Lottery Commission  
Phil Tagami, Commissioner  
California Lottery Commission  
Robert T. O'Neill, Director  
California Lottery  
Mike Ota, Deputy Director, Finance  
California Lottery  
Roberto Zavala, Chief Internal Auditor  
California Lottery

# Contents

## **Audit Report**

<b>Summary .....</b>	<b>1</b>
<b>Background.....</b>	<b>1</b>
<b>Objectives, Scope, and Methodology .....</b>	<b>1</b>
<b>Conclusion.....</b>	<b>2</b>
<b>Views of Responsible Official.....</b>	<b>2</b>
<b>Restricted Use .....</b>	<b>3</b>
<b>Findings and Recommendations.....</b>	<b>4</b>
<b>Attachment—California Lottery’s Response to Draft Report</b>	

# Audit Report

## Summary

The State Controller's Office (SCO) audited the California Lottery's (Lottery) accounts receivable for the period of July 1, 2009, through June 30, 2011.

Our audit disclosed that the Lottery did not identify uncollectible amounts for discharge and maintain adequate documentation to support collection efforts, and accounts receivable were not reviewed and discharged quarterly.

## Background

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

By authority of the California Constitution, Government Code section 12410, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, Government Code section 12411 stipulates that "... the Controller shall suggest plans for the improvement and management of revenues."

Pursuant to Government Code section 8880.67, the SCO may conduct other special post-audits of the Lottery, as the State Controller deems necessary. The Controller or his/her agents conducting an audit under this chapter shall have access and authority to examine any and all records of the California Lottery Commission.

The Lottery had approximately 644 employees, as of June 30, 2011, at different locations including the headquarters facility, two distribution centers, and nine district offices. The Lottery's Personnel Services Section is responsible for the personnel and payroll functions. The Personnel Services Section provides the personnel services mandated by state and federal laws under the direction of State control agencies, including the State Department of Personnel Administration.

## Objectives, Scope, and Methodology

The purpose of the audit was to determine whether the Lottery is maintaining effective systems of administrative and internal accounting controls over accounts receivable.

We conducted this performance audit in accordance with generally accepted government auditing standards. We did not audit the Lottery's financial statements. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The specific objectives of the audit included, but were not limited to, determining whether the Lottery has internal controls in place to ensure that:

- Policies and procedures are established for recording and collecting receivables;
- Adequate segregation of duties exists over the receivables function;
- Accounts receivable are accurately recorded and accountability is maintained;
- Collection procedures ensure appropriate action on outstanding accounts;
- The accounts receivable general ledger control account is in agreement with subsidiary ledgers, and regular reconciliations are performed to identify and correct discrepancies;
- Adequate procedures for discharge of accountability exist; and
- Adjustments to accounts receivable are reviewed, approved, and supported.

The audit period was July 1, 2009, through June 30, 2011. The scope of the audit included, but was not limited to, the following audit procedures:

- Reviewing the California Lottery Act, state laws and regulations, and any other applicable policies and procedures related to accounts receivable;
- Reviewing work performed by any external audit organization, the Lottery Internal Audits Office, or by any other Lottery unit;
- Documenting a description of the internal controls over accounts receivable encompassing the Lottery's policies and procedures;
- Analyzing and evaluating the internal controls for accounts receivable by identifying the strengths and weaknesses; and
- Performing tests to determine if control objectives are being achieved.

## **Conclusion**

Our audit disclosed that the Lottery did not identify uncollectible amounts for discharge and maintain adequate documentation to support collection efforts, and accounts receivable were not reviewed and discharged quarterly.

## **Views of Responsible Official**

We issued a draft report to the Lottery dated June 15, 2012. Robert T. O'Neill, Director, responded by letter dated July 3, 2012 (attached). Mr. O'Neill agreed with the findings and recommendations.

**Restricted Use**

This report is intended for the information and use of the California Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

October 3, 2012

# Findings and Recommendations

**FINDING 1—**

**The Lottery did not identify and discharge uncollectible amounts, and had inadequate documentation to support collection efforts**

Our audit disclosed the following deficiencies:

- The Lottery did not discharge uncollectible amounts resulting from retailer bankruptcies;
- The Lottery did not maintain adequate documentation to support retailer accounts receivable and collection efforts; and
- The Lottery did not identify in a timely manner inactive accounts for discharge.

The Lottery's Retailer Aging Report, as of June 30, 2011, contained 2,937 accounts receivable totaling \$2,785,795. We reviewed 30 accounts, totaling \$157,727 and noted that 15 of 30 (50%) accounts, totaling \$76,865, had one or more of the following exceptions:

- The retailer filed for bankruptcy and the account was not discharged;
- The retailer account file did not contain adequate documentation to support collection efforts, such as a dunning letter and/or a final or termination letter; and
- The retailer account was inactive for seven years and was not discharged in a timely manner.

State Administrative Manual (SAM) section 20050 states:

The elements of a satisfactory system of internal accounting and administrative controls, shall include, but are not limited to: A system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.

SAM section 8776.6 states:

If all reasonable collection procedures do not result in payment, departments may request discharge from accountability of uncollectible amounts due from private entities. The department will review their accounts receivables no less than quarterly to identify receivables for discharge.

The Lottery is not in compliance with SAM sections 20050 and 8776.6. The Lottery should maintain adequate records to support retailer accounts receivable liabilities and to ensure collection in a timely manner. In addition, the Lottery should maintain write-off procedures for retailers who file bankruptcy. If the Lottery does not identify and discharge uncollectible amounts in a timely manner, the result maybe an overstatement of an asset on the financial statements.

### Recommendation

The Lottery should perform the following:

- Develop and implement procedures to ensure that uncollectible amounts resulting from retailer bankruptcies are timely discharged;
- Implement a system to ensure that the Lottery maintains adequate documentation to support accounts receivable collection efforts; and
- Modify write-off procedures to ensure that accounts receivable are reviewed no less than quarterly to identify amounts for discharge.

### Lottery's Response

The Lottery agrees with the finding.

The Lottery recognizes the risk of past practices relative to bankrupt retailer accounts. To minimize this risk, the Lottery has developed policies and procedures to ensure that bankrupt retailer accounts are timely discharged.

The Lottery is also improving its efforts to maintain adequate records to support collection efforts. Staff has been working on improving practices and controls so that terminated accounts are fully supported and sent to the Lottery's collection agent and discharged in a timely manner.

On a quarterly basis, the Lottery now writes off Accounts Receivables that are aged beyond seven (7) years and have never had successful partial collections.

### SCO's Comment

The Lottery concurs with the finding and recommendation.



**FINDING 2—  
Accounts receivable  
were not reviewed and  
discharged quarterly**

Our audit disclosed that the Lottery did not review its accounts receivable quarterly to identify receivables for discharge and file an Application for Discharge from Accountability with the State Controller's Office (SCO) no less than quarterly, as required by SAM section 8776.6. The Lottery filed applications for discharge with the SCO only once during the 24-month audit period of July 1, 2009, through June 30, 2011. Currently, the Lottery writes off terminated retailer accounts that are seven to ten years old, as needed.

During the audit period, the Lottery discharged a total of \$2,400,811 of uncollectible amounts. We reviewed 20 discharged retailer accounts, totaling \$544,377, and discovered that 14 of 20, totaling \$402,134 (74%), were not discharged within seven to ten years.

SAM section 8776.6 states that the Lottery should review its accounts receivable no less than quarterly to identify receivables for discharge, and file an Application for Discharge from Accountability with the SCO for proper approvals no less than quarterly.

If the Lottery does not identify and discharge uncollectible amounts in a timely manner, the result may be an overstatement of an asset on the financial statements.

Recommendation

The Lottery should:

- Modify write-off procedures to ensure that accounts receivable are reviewed no less than quarterly to identify amounts for discharge; and
- File an Application for Discharge from Accountability with the SCO no less than quarterly, as required by SAM section 8776.6.

Lottery's Response

The Lottery agrees and will adhere to established discharge policies.

Procedures for discharging accounts have been revised to reflect new Lottery policy for quarterly review and discharge processes including filing an Application for Discharge from Accountability with the SCO.

SCO's Comment

The Lottery concurs with the finding and recommendation.

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**Attachment—  
California Lottery's  
Response to Draft Report**

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July 3, 2012

Mr. Jeffrey V. Brownfield, Chief  
Division of Audits  
State Controller's Office  
P.O. Box 942850  
Sacramento, CA 94250-5874

Re: Accounts Receivable Audit

Dear Mr. Brownfield,

The California Lottery (Lottery) offers the following comments regarding the recently concluded audit of the Lottery's Account Receivables conducted by the State Controller's Office (SCO). As stated in the audit report dated June 15, 2012, the specific objectives of the audit (for the period of July 1, 2009 through June 30, 2011) were to determine if the Lottery has internal controls in place to ensure that:

1. Policies and procedures are established for recording and collecting receivables;
2. Adequate segregation of duties exists over the receivables functions;
3. The Accounts Receivable are accurately recorded and accountability is maintained;
4. Collection procedures ensure appropriate action on outstanding balances;
5. The Accounts Receivables general ledger control account is in agreement with subsidiary ledgers and regular reconciliations are performed to identify and correct discrepancies;
6. Adequate procedures for discharge of accountability exist; and
7. Adjustments to Accounts Receivable are reviewed, approved, and supported.

We are pleased with the results of the audit and thank you for the opportunity to respond to your draft report. Although no significant internal control issues were identified, the audit identified opportunities to improve the collection process for uncollectible accounts, the quarterly Accounts Receivable review and the associated discharge procedures. The Lottery's Finance Division has implemented changes to address these issues.

Presented below are Lottery's responses to each finding:

**Finding 1**

The Lottery did not identify and discharge uncollectible amounts, and had inadequate documentation to support collection efforts.

**Recommendations**

The Lottery should perform the following:

- Develop and implement procedures to ensure that uncollectible amounts resulting from retailer bankruptcies are timely discharged;
- Implement a system to ensure that the Lottery maintains adequate documentation to support accounts receivable collection efforts; and
- Modify write-off procedures to ensure that accounts receivable are reviewed no less than quarterly to identify amounts for discharge.

**Response**

The Lottery agrees with the finding.

The Lottery recognizes the risk of past practices relative to bankrupt retailer accounts. To minimize this risk, the Lottery has developed policies and procedures to ensure that bankrupt retailer accounts are timely discharged.

The Lottery is also improving its efforts to maintain adequate records to support collection efforts. Staff has been working on improving practices and controls so that terminated accounts are fully supported and sent to the Lottery's collection agent and discharged in a timely manner.

On a quarterly basis, the Lottery now writes off Accounts Receivables that are aged beyond seven (7) years and have never had successful partial collections.

**Finding 2**

Accounts Receivable were not reviewed and discharged quarterly.

**Recommendation**

The Lottery should:

- Modify write-off procedures to ensure that accounts receivable are reviewed no less than quarterly to identify amounts for discharge; and
- File an Application for Discharge from Accountability with the SCO no less than quarterly, as required by SAM section 8776.6.

Jeffrey V. Brownfield  
July 3, 2012  
Page 3

**Response**

The Lottery agrees and will adhere to established discharge policies.

Procedures for discharging accounts have been revised to reflect new Lottery policy for quarterly review and discharge processes including filing an Application for Discharge from Accountability with the SCO.

If you have any additional questions, please contact the Audit Chief, Roberto Zavala at (916) 822-8358.

Sincerely,

A handwritten signature in black ink, appearing to read "R.T. O'Neill", with a stylized flourish at the end.

Robert T. O'Neill  
Director

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**